Supreme Court, U.S.
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No.

In the Supreme Court of the United States

THE DOW CHEMICAL COMPANY, PETITIONER,

v.

THE AES CORPORATION, RESPONDENT.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Respondent is a sophisticated business entity that agreed, before embarking on due diligence in a significant corporate transaction, that it would not rely on any of the confidential information it received from the seller unless that information was embodied in a warranty or representation that was included in the parties' final agreement. In direct violation of the promise it made in this "non-reliance" clause, respondent subsequently sued the seller and its parent company under the federal securities laws for alleged misstatements that were not even mentioned in the final agreement.

The district court granted summary judgment to petitioner on the ground that the non-reliance clause precluded respondent from claiming that it had reasonably relied on the alleged misstatements. On appeal, the Third Circuit reversed, adopting an interpretation of Section 29(a) of the Securities Exchange Act of 1934 that it acknowledged to be in direct conflict with the position taken by the Second Circuit.

The question presented is:

Whether the statutory prohibition in Section 29(a) against waivers of compliance with the federal securities laws precludes a court from giving dispositive weight to a non-reliance clause in determining whether a buyer reasonably relied upon certain representations in deciding to purchase securities.

PARTIES TO THE PROCEEDINGS

Petitioner is defendant The Dow Chemical Company ("Dow Chemical"). Respondent is plaintiff The AES Corporation ("AES").

Dynegy Power Corp., formerly known as Destec Energy, Inc., was also a defendant in the district court, but it settled and therefore was not a party to the proceeding in the court of appeals and is not a petitioner here.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Petitioner Dow Chemical is a publicly-held company. No other publicly-held company owns 10 percent or more of petitioner's stock.

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PETITION FOR A WRIT OF CERTIORARI

Dow Chemical respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-18a) is reported at 325 F.3d 174. The opinion of the district court (App., *infra*, 19a-32a) is reported at 157 F. Supp. 2d 346.

JURISDICTION

The judgment of the court of appeals was entered on April 14, 2003. Petitioner filed a timely petition for rehearing and rehearing en banc on April 28, 2003. The court of appeals denied Dow Chemical's rehearing petition on May 13, 2003. App., *infra*, 33a-34a. On August 5, 2003, Justice Souter extended Dow Chemical's time to file a petition for a writ of certiorari to and including August 18, 2003. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Section 29(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78cc(a), provides as follows:

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

STATEMENT

The question presented by this case is critical to buyers and sellers alike in any significant corporate transaction that involves a sale of securities. It is customary in such transactions for prospective buyers to be given access to large amounts of confidential information before a definitive agreement is negotiated. It is also customary for potential buyers to execute the kind of confidentiality agreement that respondent signed

here — an agreement in which the buyer acknowledges that the seller is not vouching for the accuracy of each and every bit of information provided to the prospective purchaser during the course of due diligence and, accordingly, promises not to rely on any information provided to it unless that information is confirmed by a warranty or representation in the final agreement.

The Second, Seventh, First, and D.C. Circuits have all concluded that a contractual provision that defined the representations made by the parties — and precluded any liability based on alleged representations that were *not* made in the final agreement — is fully enforceable in a securities fraud action brought under Section 10(b). *See Harsco Corp. v. Segui*, 91 F.3d 337, 344-45 (2d Cir. 1996); *Rissman v. Rissman*, 213 F.3d 381, 383-84 (7th Cir. 2000); *Jackvony v. RIHT Fin. Corp.*, 873 F.2d 411, 416 (1st Cir. 1989); *One-O-One Enterprises, Inc. v. Caruso*, 848 F.2d 1283, 1287 (D.C. Cir. 1988). In this case, however, the Third Circuit concluded that Section 29(a) precludes a court from treating a non-reliance clause as dispositive of the issue of reasonable reliance.

The Third Circuit expressly acknowledged that its interpretation of Section 29(a) was in direct conflict with the Second Circuit's decision in *Harsco*. In *Harsco*, the Second Circuit had reasoned that a non-reliance clause negotiated between sophisticated parties does not "waive" compliance with the federal securities laws; rather, it simply defines the "boundaries of the transaction" by listing the material representations on which the buyer agrees that it in fact relied. 91 F.3d at 343. The Third Circuit disagreed, finding "*Harsco*'s reasoning unpersuasive." App., *infra*, 16a. The court acknowledged that "there may be economic efficiency in allowing private parties the freedom to fashion their own bargains." *Ibid.* But it concluded that Congress had taken away the freedom of even sophisticated parties to enter into an agreement defining what information the purchaser had — and

had not — relied upon in deciding to purchase securities. *Ibid.* This Court should grant review to decide whether that is, in fact, what Congress intended in enacting Section 29(a).

A. AES's Purchase Of Destec Engineering Stock.

Dow Chemical formed Destec Energy in late 1989 to build and run power plants to supply power to Dow Chemical facilities. C.A. App. A37, ¶ 12. In 1991, Dow Chemical sold shares of Destec to the public, but remained the majority shareholder. *Id.* at A39, ¶ 16; A42, ¶ 23. Five years later, Destec hired an investment banker and began exploring a possible sale of the company. *Id.* at A46, ¶ 34. AES, a large, sophisticated company that "buys and operates power facilities domestically and internationally"(*id.* at A35, ¶ 8), was one of several potential bidders that expressed an interest in acquiring Destec.

Before AES or any other bidder was allowed to review confidential information about Destec's business, they were required to sign a Confidentiality Agreement. In that Confidentiality Agreement, which AES signed on October 24, 1996, AES specifically agreed that "we are not entitled to rely on the accuracy or completeness of the Information [provided] and that we will be entitled to rely solely on any representations and warranties as may be made to us in any definitive agreement with respect to the Transaction." C.A. App. A197, ¶ 5.[1]

After AES signed the Confidentiality Agreement, it received an Offering Memorandum from Destec. C.A. App. A47, ¶ 36. That Offering Memorandum reiterated the ground rules AES

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[1] The term "Information" is broadly defined in the Confidentiality Agreement to include "[a]ll information (whether written or oral) furnished by [Destec]" or its agents or representatives, other than information that was publicly available. C.A. App. A195.

had agreed to abide by when it signed the Confidentiality Agreement, stating that

> interested parties should conduct their own investigation and analysis of Destec and the data set forth in this Memorandum. . . . Neither Destec nor Morgan Stanley makes any express or implied representation or warranty as to the accuracy or completeness of the information contained hereinor made available in connection with any further investigation of Destec. Destec and Morgan Stanley expressly disclaim any and all liability which may be based on such information, errors therein or omissions therefrom. [AES] shall be entitled to rely solely on any representations and warranties made to it by Destec in any final acquisition agreement, if any. . . .

Ibid.

The Offering Memorandum included projections and estimates about the future performance of various aspects of Destec's business. The Memorandum made it clear, however, that AES and other potential bidders could not reasonably rely on these projections in purchasing assets from Destec unless they were able to negotiate a specific warranty or representation in the final agreement confirming the information that had previously been provided:

> This Memorandum includes certain statements, estimates and projections provided by Destec with respect to its anticipated future performance. Such statements, estimates and projections reflect various assumptions which may or may not prove to be correct. No representations are made as to the accuracy of such statements, estimates or projections. Only

> those particular representations and warranties which may be made to a purchaser in a definitive agreement, when, as, and if executed, and subject to such limitations and restrictions as may be specified in such definitive agreement, shall have any legal effect.

C.A. App. A319-320.

The Offering Memorandum was accompanied by a Financial Supplement. That Supplement repeated for a third time that Destec made no representations regarding the accuracy of estimates or projections and cautioned once again that AES was entitled to rely solely on representations made in a "final" agreement. C.A. App. A325-326. The Financial Supplement outlined numerous Destec assets, including five "Destec Owned Projects," twenty "Equity Projects," and five "Destec Fuel Resources Projects." *Id.* at A327-328.

Ultimately, the assets described in the Offering Memorandum and other documents provided to bidders in the fall of 1996 were sold for $1.2 billion. C.A. App. A53, ¶ 48. This case involves only one of the thirty projects discussed in the Financial Supplement — a project that AES itself valued at less than 3% of the total assets being sold. The project in question is the Elsta power plant, which was then under construction in Terneuzen, The Netherlands. The Elsta project was the major asset of Destec Engineering, Inc. ("DEI"), which was a wholly-owned subsidiary of Destec. *Id.* at A33, ¶ 1.

The Offering Memorandum provided to AES and other bidders predicted that the Elsta plant would be "commercially operational" by October 1, 1997. AES alleges that the information in the Offering Memorandum also suggested that the Elsta plant would yield a $38 million engineering profit. C.A. App. A47, ¶ 35. The Financial Supplement contained additional information, listing the numerous permits Elsta officials had already secured and predicting that DEI would

have no difficulty in securing the two additional permits that were necessary to complete the project. *Id.* at A50-51, ¶ 42.

After receiving the Offering Memorandum, AES contacted Dow Chemical about acquiring all of Destec's international assets, including DEI. C.A. App. A47, ¶ 36. Dow Chemical responded that it wanted to sell the entire company, rather than disposing of it piecemeal. *Ibid.* AES then partnered with NGC Corporation, and the two began working towards a joint bid for the purchase of Destec. *Ibid.*

AES scrutinized Destec's international operations for approximately fourteen weeks, between October 1996 and February 17, 1997. AES reviewed documents that Destec made available in a document room in Houston and attended a presentation by Destec officers on December 20, 1996. C.A. App. A48, ¶ 37. On February 7, 1997, AES representatives visited the Elsta plant, along with an outside engineering firm that AES had hired to advise it. *Id.* at A51, ¶ 44; A52, ¶ 44. AES alleges that during that site visit it was assured by Destec officials that the plant would be substantially complete by September 30, 1997. AES acknowledges that it was advised that two permits had yet to be secured, one from the country's steam regulation body and another from the country's "Gas Unie," but claims that it was told that there were no "known problems" in obtaining either permit. *Ibid.*

In early February, 1997, Destec had sent all potential bidders, including AES, a copy of an internal Destec memo explaining that DEI had lowered its estimated engineering profit figure for the Elsta Project to $31 million. C.A. App. A51, ¶ 43. On their site visit, AES representatives asked about the lowered profit projections for the project. AES alleges that it was told there had been unanticipated expenses from boiler problems that arose in late 1996, that this was a "one time event," and that it was not anticipated that there would be any further reductions in the projected engineering profit. *Id.* at

A52, ¶ 45. AES does not allege what, if any, independent investigation it conducted in order to make a judgment on the reasonableness of these predictions.

On February 10, 1997, AES and NGC submitted a successful joint bid to acquire Destec for a total purchase price of $1.2 billion. C.A. App. A53, ¶ 48. AES agreed to pay $407,055,000 for all of Destec's international assets, including the stock of DEI. *Id.* at A52, ¶ 46. AES claims that in arriving at this bid it valued DEI at $31 million — precisely the amount of the most recent profit projection for the Elsta Project. *Ibid.*

On February 17, 1997, AES, NGC and Dow Chemical agreed on a two-step transaction for the sale of Destec. C.A. App. A43, ¶ 48. First, Destec would merge with a new, wholly-owned subsidiary of NGC, with NGC paying $21.65 per share to all of Destec's shareholders in exchange for 100% of Destec's stock. *Ibid.* Then, NGC would sell all of Destec's international assets, including all of the stock of DEI, to AES for the $407 million AES had agreed to pay for those assets. *Ibid.*

The first step of the transaction, NGC's merger with Destec, was laid out in a Merger Agreement between Destec and Dow Chemical on the one hand and NGC and its newly-created subsidiary on the other. The Merger Agreement, which was dated as of February 17, 1997, incorporated the Confidentiality Agreement by reference, providing in Section 9.9 that "[t]his Agreement and the Confidentiality Agreement, and certain other agreements executed by the parties . . . constitute the entire agreement, and supersedes all prior agreements and understandings (written and oral), among the parties with respect to the subject matter thereof." C.A. App. A265.

Together with the Confidentiality Agreement, the Merger Agreement made it clear that Destec and Dow Chemical had not made and were not making any representations or warranties other than those expressly set forth in the Merger Agreement.

Section 3.20 of the Merger Agreement reiterated the bargain the parties had originally made in the non-reliance clause of the Confidentiality Agreement, providing that "[e]xcept for the representations and warranties contained in this Article III, neither [Destec] nor any other Person makes any other express or implied representation or warranty on behalf of the Company." C.A. App. A233. *See also id.* at A235, § 4.6 (using the same language to limit Dow Chemical's representations and warranties to those made in Article IV).

Articles III and IV of the Merger Agreement contained a number of representations and warranties made by Destec and Dow Chemical. Those representations and warranties dealt with such crucial topics as capitalization, the absence of undisclosed liabilities, employee benefit plans, litigation, intellectual property matters, taxes and environmental matters. C.A. App. A201 (Table of Contents). In addition, Destec represented and warranted the material accuracy and completeness of its periodic SEC filings, including its annual reports, 10-Q's and proxy statements. *Id.* at A219, § 3.5. Conspicuously absent from the Merger Agreement, however, were any representations or warranties about the projections and other confidential information that had been provided to bidders about the Elsta Project.

The second step in the transaction was governed by an Asset Purchase Agreement, which was also dated as of February 17, 1997, between NGC and AES. That Agreement reflects the fact that NGC was acting essentially as a middleman with respect to Destec's international assets. As a result, NGC offered AES only a short list of very limited warranties and representations with respect to its authority to consummate the transaction.

The Asset Purchase Agreement makes clear that, in buying Destec's international assets, including the stock of DEI, AES was relying on the representations and warranties made by Destec and Dow Chemical in the Merger Agreement. Thus,

Section 7.1 provides that AES was not required to close the purchase unless the merger was consummated without any modification or waiver of any of the Merger Agreement's warranties, representations and conditions that materially affected Destec's international assets.

B. Proceedings Below.

The Elsta plant went into operation in September 1998 — approximately eleven months after the originally-anticipated date of October 1, 1997. C.A. App. A34, ¶ 2. AES claims that the construction delay cost it $70 million. On November 30, 1998, AES filed this lawsuit in federal court for the Southern District of Texas, suing Dow Chemical (and Dow Chemical alone) for more than $100 million for alleged fraud in connection with AES's purchase of DEI's stock. Federal subject matter jurisdiction was predicated on Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and 28 U.S.C. §§ 1331 and 1337.

Following the transfer of the action to the District of Delaware pursuant to 28 U.S.C. § 1404(a), AES filed an amended complaint naming both Dow Chemical and Destec as defendants. AES alleged, among other things, that employees of DEI or Destec must have known about various engineering problems that ultimately caused or contributed to the delay in starting up the Elsta plant and therefore must have realized that the profit projections and predictions about permits and schedules that were provided to AES could not be achieved. C.A. App. A59-60, ¶ 63(c), (d), (e). AES sued Destec itself for securities fraud under Section 10(b) of the Exchange Act and sought to hold Dow Chemical liable as a control person under Section 20(a) of the Act. AES also brought various state law claims against the defendants.[2]

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[2] Destec (later renamed Dynegy Power Corp.) subsequently settled with AES and therefore dropped out of the case.

Dow Chemical moved to dismiss the amended complaint in its entirety. In that motion, Dow Chemical argued (among other things) that it was entitled to dismissal, because the non-reliance provisions in the governing agreements precluded AES, as a matter of law, from proving that it had reasonably relied on the alleged misstatements about the Elsta project. The district court denied the motion to dismiss on January 19, 2001, suggesting that the non-reliance argument was more appropriately made on a motion for summary judgment. C.A. App. A103. Thereafter, Dow Chemical filed a motion for summary judgment, relying solely on the undisputed provisions of the governing documents. *Id.* at A111.

On August 2, 2001, the district court granted Dow Chemical's motion for summary judgment on AES's federal securities law claim and dismissed its state law claims for lack of supplemental jurisdiction. App., *infra*, 19a-32a. The court concluded that, as a matter of law, AES would be unable to prove that it had reasonably relied on any statements Destec might have made about the Elsta Project because (i) AES had expressly agreed that it would rely *only* on the representations and warranties that appeared in the final agreement and (ii) that agreement did not contain any warranties or representations about the Elsta Project. *Id.* at 28a-29a. The district court rejected AES's argument that the non-reliance clause was an impermissible advance waiver of its rights under the Exchange Act. In so doing, the district court adopted the view expressed by the Second Circuit in *Harsco Corp. v. Segui*, 91 F.3d 337, 344-45 (2d Cir. 1996), that a negotiated non-reliance clause simply defines the representations being made by the seller and therefore is not an impermissible waiver of compliance under Section 29(a). App., *infra*, 30a. The court also rejected AES's

claim that discovery was necessary before the issue of reasonable reliance could be properly decided. *Id.* at 31a.[3]

On appeal, the Third Circuit did not dispute the district court's conclusion that, absent Section 29(a), the non-reliance clause would be dispositive of AES's claims under the Exchange Act. It held, however, that "enforcement of the non-reliance clauses to bar AES's fraud claims as a matter of law would be inconsistent with Section 29(a)['s]" prohibition on advance waivers of compliance with the federal securities laws. App., *infra*, 9a. The court explained its reasoning as follows:

> As we have noted, reliance is an essential element of a Rule 10b-5 claim. It necessarily follows that, if a party commits itself never to claim that it relied on representations of the other party to its contract, it purports anticipatorily to waive any future claim based on the fraudulent representations of that party. The same is true if the commitment is more limited, e.g., a promise not to claim reliance on any representation not set forth in the agreement. The scope of the anticipatory waiver is more limited, but it is nevertheless an anticipatory waiver of potential future claims under Rule 10b-5.

Id. at 10a.

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[3] No discovery had been taken in the case prior to the ruling on the motion for summary judgment. Discovery was automatically stayed under the Private Securities Litigation Reform Act until the motion to dismiss was denied in January 2001. When Dow Chemical filed its summary judgment motion in March 2001, it sought and was granted a further stay of discovery until that motion was decided.

While concluding that the non-reliance clause could not be dispositive, the majority nevertheless held that the existence of such a provision was "one of the circumstances to be taken into account in determining whether the plaintiff's reliance was reasonable." App., *infra*, 17a. Judge Wallace dissented on this point, taking the position that the non-reliance clause could not be considered at all in deciding whether AES had reasonably relied on the statements in question. *Id.* at 17a-18a.

The majority stated that on remand the issue would be whether AES "exercise[d] ordinary care in protecting its own interest." App., *infra*, 11a-12a. The majority acknowledged that, in light of the non-reliance clause, AES could not simply rely on seller-provided information without attempting to verify it. But it held that AES was entitled to discovery to support its claim that Dow Chemical and Destec "intentionally concealed their fraudulent conduct, restricted its access to truthful information, and accelerated the transaction to prevent AES from discovering the true status of the construction at the Elsta Plant." *Id.* at 13a.

The court acknowledged that its refusal to enforce the non-reliance clause in accordance with its plain terms frustrated one of the key objectives of a non-reliance clause — "the avoidance of costly discovery." App., *infra*, 14a. But the court concluded that "to hold that a buyer is barred from relief under Rule 10b-5 solely by virtue of his contractual commitment not to rely would be fundamentally inconsistent with Section 29(a)" and thus "parties in Dow's position will have to rely upon discovery management and the summary judgment process to ameliorate the discovery burden." *Ibid.*

REASONS FOR GRANTING THE PETITION

This Court should review the Third Circuit's decision because the circuits are split over the recurring and important issue of whether Section 29(a) limits the enforceability of a non-reliance clause in a negotiated agreement for the sale of securities.

The split in the circuits over this issue is undeniable. The Third Circuit itself acknowledged that its decision was directly contrary to the Second Circuit's decision in *Harsco Corp. v. Segui*, 91 F.3d at 344-45. As demonstrated below, the split created by the decision in this case extends well beyond the *Harsco* case, bringing the Third Circuit into conflict with a recent Seventh Circuit decision as well as decisions by the First and D.C. Circuits.

Moreover, the issue raised by this case is likely to arise again and again in significant corporate transactions like the acquisition at issue here. Non-reliance provisions have become a well-accepted feature of such transactions, because they serve a number of important functions. Among other things, a non-reliance clause "ensures that both the transaction and any subsequent litigation proceed on the basis of the parties' writings, which are less subject to the vagaries of memory and the risks of fabrication." *Rissman v. Rissman*, 213 F.3d at 384. As Judge Easterbrook observed in *Rissman*, "[s]tock transactions would be impossibly uncertain if federal law precluded parties from agreeing to rely on the written word alone." *Id.* at 383.

The Third Circuit's decision in this case creates a conflict in the Circuits in an area of law where certainty is essential. Parties to stock purchase agreements need to know, at the time the contract is negotiated, whether a non-reliance clause will be enforced in accordance with its terms — that is, whether it will effectively preclude any and all claims based on alleged representations that the buyer had explicitly agreed *not* to rely

upon. The enforceability of a non-reliance clause under the federal securities laws should not vary depending on the Circuit in which a disappointed purchaser chooses to bring suit.

I. THE THIRD CIRCUIT'S DECISION CREATES MULTIPLE CONFLICTS WITH OTHER CIRCUITS.

A. The Third Circuit Specifically Acknowledged That Its Decision Created A Conflict With The Second Circuit.

As the Third Circuit acknowledged, this case is indistinguishable from *Harsco*. In *Harsco*, the plaintiff was a steel manufacturer that was hoping to expand its international operations. 91 F.3d at 340. After receiving an Offering Memorandum from the defendant seller, Harsco negotiated a lengthy agreement in which it agreed to buy stock and assume certain of the sellers' debts in return for more than $100 million.

The purchase agreement contained an integration clause, providing that it was the sole agreement between the parties. It also included fourteen pages of representations and warranties covering capitalization, financial statements, liabilities, litigation exposure, taxes and environmental matters. 91 F.3d at 340. The parties specifically agreed that this section embodied *all* of the representations that had been made by the sellers, providing that the sellers "shall not be deemed to have made to Purchaser any representation or warranty other than as expressly made by [the sellers]" in the written agreement. *Id.* at 342. They also agreed that the sellers were not making any representations or warranties regarding information that had previously been provided to the buyer in the Offering Memorandum or during due diligence, including "any projections, estimates or budgets heretofore delivered to or made available to Purchaser of future revenues, expenses or expenditures, future results of operations (or any component thereof), future cash flows or future financial condition (or any component thereof)." *Id.* at 345.

After the deal closed, Harsco sued the sellers under the federal securities laws and common-law fraud theories, claiming that certain projected plant schedules that had been provided to it were false or misleading. The Second Circuit upheld the dismissal of the complaint, on the ground that the purchaser was not entitled, as a matter of law, to recover under the securities laws for "conduct that f[ell] outside" the negotiated representations and warranties. 91 F.3d at 343.

As AES did in this case, Harsco resisted defendant's motion to dismiss on the ground that Section 29(a) precluded the defendants from enforcing the non-reliance clause in the face of Harsco's claim that it had been deliberately defrauded by representations that were not embodied in the final agreement. In support of its Section 29(a) argument, Harsco cited this Court's decision in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987). In *Shearson*, the Court had concluded that an arbitration clause did not constitute an advance waiver of compliance with the securities laws because the agreement to arbitrate did not "weaken[] [plaintiff's] ability to recover under the Exchange Act." *Id.* at 230. Harsco argued that a non-reliance clause did impermissibly "weaken" its ability to recover under Section 10(b) and thus ought to be considered void.

The Second Circuit rejected Harsco's argument. The court concluded that the non-reliance clause did not "waive" compliance with the federal securities laws, but rather simply defined the "boundaries of the transaction" by listing the representations on which the buyer relied. 91 F.3d at 343. As the Second Circuit explained,

> Harsco bought the representations [in the final agreement] and, according to Sections 2.05 and 7.02, nothing else. This means that there are fourteen pages of representations, any of which, if fraudulent, can be the basis of a fraud action

> against the sellers. But Harsco specifically agreed that representations not made in those fourteen pages were not made.

Id. at 344. Under these circumstances, it was "not fair to characterize" the non-reliance provisions "as having prevented Harsco from protecting its substantive rights. Harsco rigorously defined those rights in Section 2.04 [of the agreement]." *Ibid.*

The Second Circuit recognized that a non-reliance clause could function as an impermissible waiver if, for example, a seller made no real representations or warranties in the agreement, so that the non-reliance clause effectively served as a waiver of the buyer's right to bring any suit. The court distinguished the First Circuit's decision in *Rogen v. Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966), on which the Third Circuit here relied (*see* App., *infra*, 10a-11a), on the ground that it involved the kind of sweeping disclaimer that was tantamount to a waiver of compliance with the federal securities laws. The Second Circuit described *Rogen* as a situation where the defendant company had induced an unsophisticated and "overtrusting" shareholder to sell his stock back to the company pursuant to an agreement in which he purported to disclaim reliance on "*any* representations or obligations to make full disclosure" on the part of the company. 91 F.3d at 343-44 (quoting *Rogen*) (emphasis added).

In its opinion in this case, the Third Circuit recounted the reasoning in *Harsco* at length and then rejected it as "unpersuasive." App., *infra*, 16a. It also disagreed with the Second Circuit's attempt to distinguish *Rogen* "on the grounds that it did not involve sophisticated parties or as detailed an agreement as that before it." *Id.* n.4. The court stated that the First Circuit's decision in *Rogen* did not "turn on these factors" and opined that Section 29(a) is not "susceptible of [a] reading that would make an exception for sophisticated parties and detailed agreements." *Ibid.*

Thus, in the Third Circuit's own view, there is a clear split between the Third and First Circuits on the one hand and the Second Circuit on the other. Although we continue to believe that *Rogen* and *Harsco* can be harmonized, there is no way to reconcile the Third Circuit's flat refusal to enforce *any* non-reliance clause, no matter how clearly bargained for between sophisticated parties, with the Second Circuit's diametrically opposite view in *Harsco*.

B. The Third Circuit's Decision Also Conflicts With Decisions By The Seventh, First And D.C. Circuits.

Harsco is not the only decision that is in conflict with the Third Circuit's decision in this case, however. The decision is also contrary to the Seventh Circuit's decision in *Rissman*. In that case, a shareholder in a closely held, family company sold his stock to his brother for $17 million. In the parties' agreement, the buyer warranted and represented (accurately) that he was not aware of any offers to purchase the company and was not engaged in any negotiations to sell it. The buyer declined, however, to represent that he would *never* sell the company or take it public. The agreement expressly limited the seller's reliance to the representations set forth in the agreement, providing that the seller had signed it "without reliance upon any statement or representation by Purchaser, the Company, [or any of their affiliates or agents]." 213 F.3d at 383. A little over a year after the agreement was signed, the company was sold for $335 million. The brother who failed to benefit from the sale sued for alleged violations of Section 10(b), seeking an extra $95 million on the ground that he had relied on oral representations by his brother that he would never sell the company. *Id.* at 382.

The district court granted summary judgment on the plaintiff's Section 10(b) claim. On appeal, the Seventh Circuit affirmed. The court assumed, for purposes of argument, that the brother who bought the stock had lied about his intention not to

sell the company. Nevertheless, the court concluded that the seller could not have reasonably relied on that misstatement in making his decision to sell his stock because, as a matter of law, the "anti-reliance" clause in the agreement "precludes any claim of deceit by prior representations." 213 F.3d at 384. As Judge Easterbrook explained, "[s]ecurities law does not permit a party to a stock transaction to disavow such representations — to say, in effect, 'I lied when I told you I wasn't relying on your prior statements' and then to seek damages for their contents. Stock transactions would be impossibly uncertain if federal law precluded parties from agreeing to rely on the written word alone." *Id.* at 383.

In reaching its decision, the Seventh Circuit cited *Jackvony v. RIHT Fin. Corp.*, 873 F.2d 411, 416 (1st Cir. 1989) (Breyer, J.), and *One-O-One Enterprises, Inc. v. Caruso*, 848 F.2d 1283, 1287 (D.C. Cir. 1988) (Ruth Bader Ginsburg, J.), for the proposition that "non-reliance clauses in written stock-purchase agreements preclude any possibility of damages under the federal securities laws for prior oral statements." 213 F.3d at 383. In both of those cases, the courts concluded that the plaintiffs' alleged reliance on oral statements made before a negotiated agreement was signed was unreasonable in light of simple integration clauses superseding all prior agreements. Indeed, as then-Judge Ginsburg explained in *One-O-One Enterprises*, "[w]ere we to permit plaintiffs' use of the defendants' prior representations . . . to defeat the clear words and purpose of the Final Agreement's integration clause, contracts would not be worth the paper on which they are written." 848 F.2d at 1287.

All of these cases are directly at odds with the Third Circuit's decision here. The Third Circuit tried to distinguish these cases on the ground that none of them explicitly discussed the enforceability of a non-reliance clause in light of Section 29(a). But it is highly unlikely that all three courts simply *missed* the Section 29(a) issue. That is particularly true in the

Rissman case, where the district court had specifically rejected the argument that the non-reliance clause was unenforceable under Section 29(a). *See Rissman v. Rissman*, 1999 U.S. Dist. LEXIS 10611, at *47 (N.D. Ill. June 30, 1999).

Although Judge Easterbrook did not expressly address the effect of Section 29(a) in his opinion for the court in *Rissman*, he left no doubt of his view that a non-reliance clause *promotes* the policies underlying the securities laws. 213 F.3d at 384. As he explained, "[f]ailure to enforce" non-reliance agreements "could not make sellers of securities better off in the long run. Faced with an unavoidable risk of claims based on oral statements, [buyers of] securities would reduce the price they pay, setting aside the difference as a reserve for risk." *Ibid.* The same analysis applies in a case like this: If a seller cannot limit its risk by limiting its representations to those expressly included in the parties' written agreement, then the seller will either severely limit the information it provides to prospective buyers or insist on a higher price to compensate it for the increased risks associated with allowing claims based on representations not included in the contract.

The Third Circuit also suggested that *Rissman*, *Jackvony*, and *One-O-One Enterprises* provide "some support" for the approach it adopted because each of them supposedly treated "the existence of the non-reliance clause as one of the circumstances to be taken into account in determining whether the plaintiff's reliance was reasonable." App., *infra*, 16a-17a. In fact, however, none of these cases supports the view that a non-reliance clause cannot be dispositive and must always be treated as only "one of the circumstances" in deciding whether the plaintiff reasonably relied on an alleged extra-contractual representation.

Indeed, the majority opinion in *Rissman* reaches precisely the opposite conclusion. Writing for the majority, Judge Easterbrook held that reliance cannot be treated as a question of

fact once the court concludes that the plaintiff "warranted his non-reliance" because doing so would effectively nullify the promise made in the non-reliance clause. 213 F.3d at 385. In a concurring opinion, Judge Rovner criticized the majority's view that a non-reliance clause should "automatically" preclude a claim of reasonable reliance. But Judge Rovner did not suggest that a non-reliance clause cannot be dispositive. On the contrary, she acknowledged that the existence of a non-reliance clause "may be determinative in many — and perhaps most — cases." *Id.* at 388. Judge Rovner suggested that a non-reliance clause should not be dispositive only in situations where there is a factual question as to whether the plaintiff knowingly agreed to such a provision — because the plaintiff was too unsophisticated, the warnings were not sufficiently clear, or a "boilerplate" provision was hidden in a lengthy agreement that the plaintiff could not reasonably have been expected to understand. *Id.* at 388-89. In the *Rissman* case itself, Judge Rovner voted to affirm the entry of summary judgment because the undisputed facts surrounding the negotiation of the agreement showed that the plaintiff should have understood that he could not reasonably rely on oral representations that were not included in the final agreement. *Id.* at 389.

In subsequent district court cases, courts have read *Rissman* as requiring the dismissal of securities fraud claims when, notwithstanding a non-reliance clause, the plaintiff sues based on representations allegedly made outside the four corners of the parties' agreement. *See Heartland Fin. USA, Inc. v. Financial Inst. Capital Appreciation Partners*, 2002 U.S. Dist. LEXIS 24052, at *18 (N.D. Ill. Dec. 12, 2002) (granting a motion to dismiss plaintiff's claim under Section 10(b) based on a non-reliance clause, in light of *Rissman's* unequivocal statement that "'a written anti-reliance clause precludes any claim of deceit by prior representations'"); *Tirapelli v. Advanced Equities, Inc.*, 215 F. Supp. 2d 964, 971-72 (N.D. Ill. 2002) (granting summary judgment on plaintiffs' claims under

Section 10(b) because a non-reliance clause precluded plaintiffs from proving that they reasonably relied on alleged misstatements "as to which [the governing documents] are silent").

The First Circuit's decision in *Jackvony* also does not support the view that a non-reliance clause cannot be dispositive. In that case, the First Circuit concluded, as a matter of law, that a sophisticated investor who had "helped draft the written acquisition documents" could not claim to have relied on alleged pre-agreement oral representations about the acquiring company's plans because (i) those representations were not included in a merger agreement that contained an explicit integration clause and (ii) the proxy statement supplied to all investors specifically warned that any "information or representation" that was not contained in the proxy statement "should not be relied upon." 873 F.2d at 416.

Similarly, in *One-O-One Enterprises*, the court affirmed the dismissal of a securities fraud complaint based on alleged representations that were not embodied in the parties' final agreement. The court noted that the final agreement had been signed after "eight months of vigorous negotiations" and that it contained an integration clause that specifically superseded all previous agreements and understandings. Under those circumstances, the court concluded that, as a matter of law, plaintiffs could not prove that they had reasonably relied on representations that had allegedly been made before the final agreement was executed. 848 F.2d at 1286.

In each of these cases, the court concluded that a non-reliance clause or an integration clause was dispositive of the issue of reasonable reliance. Although there was some discussion in these cases concerning the facts surrounding the negotiation of the agreement, all of them focused on the question of whether the plaintiff should have understood the import of the non-reliance clause he was signing. In this case,

AES has never denied that it was a sophisticated purchaser, represented by experienced counsel, and that it understood precisely what it was agreeing to when it signed the Confidentiality Agreement and obtained access to confidential information based on the non-reliance clauses. Under all of the cases cited above, that would be enough to hold AES to the promise it made and to conclude, as a matter of law, that AES cannot meet its burden of proving that it justifiably relied on any alleged representations that were not embodied in a final agreement.

II. THE ENFORCEABILITY OF A NON-RELIANCE CLAUSE IS A RECURRING ISSUE OF SUBSTANTIAL IMPORTANCE IN NEGOTIATED SECURITIES TRANSACTIONS.

The issue raised by this case is both important and recurring. Non-reliance clauses are a common feature of significant corporate transactions because they serve a number of important — and entirely legitimate — functions. As the Seventh Circuit observed in *Rissman*, enforcing a non-reliance clause promotes certainty in commercial relationships. 213 F.3d at 383. The Delaware Chancery Court made the same point recently when it dismissed a common law fraud-in-the-inducement claim brought by a sophisticated purchaser on the ground that the claim was barred by a non-reliance clause:

> Were this Court to allow [the buyer] to disregard the clear terms of its disclaimers and to assert its claims of fraud, the carefully negotiated and crafted Purchase Agreement between the parties would . . . not be worth the paper it is written on. To allow [the buyer] to assert, under the rubric of fraud, claims that are explicitly precluded by contract, would defeat the reasonable commercial expectations of the

> contracting parties and eviscerate the utility of written contractual agreements.

Great Lakes Chem. Corp. v. Pharmacia Corp., 788 A.2d 544, 556 (Del. Ch. 2001); *accord Progressive Int'l Corp. v. E.I Du Pont de Nemours & Co.*, 2002 Del. Ch. LEXIS 91, at *26-29 (July 9, 2002).

The use of non-reliance clauses also promotes the free flow of information. By obtaining a promise at the outset that potential bidders will not rely on any information unless it is confirmed by a representation in the final agreement, the seller can be assured that granting broad access to its employees and non-public information will not lead to later disputes about who said what, what the speaker "should have" or "must have known," whether the speaker was authorized to make representations on behalf of the seller, what information was material to the buyer, and whether it was reasonable for the buyer to rely on the information. When the warranties and representations are expressly negotiated, *both* parties understand precisely what has and has not been represented, and each side can therefore make a proper evaluation of the value of the transaction to it.

By contrast, if a reasonably-drawn non-reliance provision could not be enforced in accordance with its terms, sellers would have a powerful incentive to deny bidders access to plant sites, employees, and confidential information such as profit projections and construction schedules, in order to avoid the risk and expense of litigating precisely the kind of lawsuit that AES filed here. A company that is selling a billion-dollar business would never share its internal projections with a potential bidder if it could subsequently be sued for securities fraud whenever those projections turned out to be inaccurate. Nor would such a company allow a bidder to speak directly to its employees if it could be sued for securities fraud if the buyer

later decided that an individual employee had been shading the truth.

Enforcing a non-reliance clause also prevents buyers from engaging in sharp practices. This case illustrates the point. Before AES received a scrap of confidential information about Destec, it expressly agreed that it would *not* rely on any information, whether written or oral, that it received during the course of its due diligence efforts unless that information was subsequently embodied in a representation or warranty in a final agreement. Thus, if AES believed that the information provided to it about the Elsta plant was material to its decision to bid on Destec's international assets, it had two choices: either obtain independent verification from a third party or bargain for protection in the form of a representation or warranty in the final agreement. AES did neither. Instead, AES now seeks to renege on the promise embodied in the non-reliance provisions of the governing agreements by claiming that it relied on precisely the kind of statement it expressly agreed was *not* reliable. Whether or not that is a tactic that is permissible under the federal securities laws is an issue that warrants this Court's review.

III. THIS COURT'S OPINION IN *SHEARSON* DOES NOT COMPEL THE RESULT REACHED BY THE THIRD CIRCUIT.

This Court should also grant review of the Third Circuit's decision in this case because it misinterprets this Court's decision in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987). In that case, the issue was whether an arbitration clause included as a standard term of a customer agreement with a brokerage firm should be deemed void under Section 29(a). In response to the argument that the customers had knowingly and voluntarily agreed to arbitrate any disputes, the Court observed that the issue for purposes of Section 29(a) was not whether the clause was enforceable as a matter of

contract law, but rather whether the agreement to arbitrate "weakens [the customers'] ability to recover under the Exchange Act." 482 U.S. at 230. The Court concluded that arbitration under procedures subject to the SEC's authority did not weaken the customers' ability to enforce their rights under the Exchange Act and that Section 29(a) was therefore inapplicable.

In this case, the Third Circuit interpreted this Court's decision in *Shearson* as compelling the conclusion that, no matter how sophisticated the parties or how detailed their agreement, a non-reliance clause can never be dispositive of the issue of reliance in a federal securities fraud case. The court took it as a given that an agreement that the purchaser would only rely on warranties and representations made in a final agreement weakens the purchaser's ability to recover under the Exchange Act and that Section 29(a) therefore applies, if not to void the purchaser's non-reliance promise entirely, at least to render it unenforceable in accordance with its plain terms.

The Third Circuit's rationale is circular, however. Section 29(a) does not come into play unless the court first decides that the plaintiff had a viable claim under the federal securities laws. *See Hamilton v. Harrington*, 807 F.2d 102, 104 (7th Cir. 1978). To put it another way, an advance agreement to "waive" a non-existent claim does not weaken the purchaser's ability to recover under the Exchange Act — the purchaser by definition had no ability to recover in the first place.

In order to have a viable claim under the Exchange Act, a purchaser of securities must have reasonably relied on a materially misleading statement. When a prospective seller supplies information that is obviously unreliable or immaterial because it is hedged around with cautionary statements, the purchaser has no claim for securities fraud. *See, e.g., Halperin v. eBanker USA.com*, 295 F.3d 352, 357 (2d Cir. 2002). The situation is no different in a case like this, where the prospective

buyer expressly *agrees* that the information being supplied to it cannot -- and indeed will not — be relied upon unless it is confirmed in a final agreement.

Furthermore, as the Second Circuit concluded in *Harsco*, a non-reliance clause that merely "defines the boundaries" of the parties' transactions does not weaken the ability of an investor to recover under Section 10(b). In fact, non-reliance clauses may actually *strengthen* a purchaser's position in post-transaction litigation. *See Harsco*, 91 F.3d at 343-44. When the parties specifically list the seller's representations and warranties, both parties are agreeing what the representations were, that they were material, and that the buyer acted reasonably in relying on them. *See, e.g., Rissman,* 213 F.3d at 383; *see also* Ludwig Mandel, THE PREPARATION OF COMMERCIAL AGREEMENTS 23 (1978). If the buyer later claims that a representation set forth in such an agreement was false, he will have only two elements left to establish a claim under Section 10(b): falsity and scienter. Thus, rather than preventing a disappointed buyer from pursuing its rights under Section 10(b), a negotiated agreement that contains both a non-reliance clause and specific representations and warranties "rigorously define[s]" and protects the rights the buyer negotiated. *Harsco*, 91 F.3d at 344.[4]

Far from weakening disclosure obligations under the federal securities laws, negotiated non-reliance clauses affirmatively promote the policies embodied in the federal securities laws. The court in *Rissman* observed that "promoting the primacy of the written word is a principal function of the federal securities laws." 213 F.3d at 384. The policies embodied in the Exchange

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[4] Indeed, a buyer who obtains specific contractual representations and warranties will ordinarily be able to recover for breach of contract simply by proving that a representation was false or that a particular outcome failed to materialize as promised.

Act would not be served by precluding sophisticated parties from negotiating reasonable non-reliance clauses in agreements for the sale of securities.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

AES CORP., *Appellant*,

v.

THE DOW CHEMICAL COMPANY; DYNEGY POWER CORPORATION F/K/A DESTEC ENERGY INC.

No. 01-3373

Argued May 23, 2002.
Filed April 14, 2003.

Before MCKEE, STAPLETON and WALLACE,* *Circuit Judges*.

OPINION OF THE COURT

STAPLETON, *Circuit Judge*.

I. Introduction

The AES Corporation ("AES") operates power facilities. AES alleges that Dow Chemical Company ("Dow") and its

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* Honorable J. Clifford Wallace, United States Circuit Judge for the Ninth Circuit, sitting by designation.

subsidiary, Destec Energy, Inc. ("Destec"),[1] violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act") in connection with a transaction in which AES purchased the stock of one of Destec's subsidiaries, Destec Engineering, Inc. ("DEI"). DEI's sole asset was a contract to design and construct a power plant in The Netherlands (the "Elsta Plant"). According to AES, Dow and Destec conspired to sell DEI at an artificially inflated price by making misrepresentations material to an evaluation of DEI.

During the pendency of this case in the District Court, AES and Destec entered into a settlement agreement. Thus, only the claims against Dow remain. There has been no discovery. Dow moved for summary judgment, relying solely on documents relating to the transactions in which AES acquired DEI's stock. In response, AES filed a Rule 56(f) affidavit requesting discovery in identified areas. The District Court nevertheless granted Dow's summary judgment motion. The District Court held that certain clauses in the transaction documents rendered AES's reliance on the alleged misrepresentations unreasonable as a matter of law.

II. Background

Dow formed Destec to build and run power plants that would supply power to Dow Chemical facilities and third-party users. In 1996, after determining that it could not profitably run Destec as its subsidiary, Dow retained Morgan Stanley to perform a valuation of Destec in order to initiate a public sale.

Morgan Stanley issued a Confidential Offering Memorandum on behalf of Destec. As a precondition to receiving the Offering Memorandum, AES signed a Confidentiality Agreement that provided in part:

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[1] Destec has since changed its name to Dynegy Power Corporation.

> We [AES] acknowledge that neither you [Destec], nor Morgan Stanley [Destec's Investment Banker] or its affiliates, nor your other Representatives, nor any of your or their respective officers, directors, employees, agents or controlling persons within the meaning of section 20 of the Securities Exchange Act of 1934, as amended, make any express or implied representation or warranty as to the accuracy or completeness of the Information, and we agree that no such person will have any liability relating to the Information or for any errors therein or omissions therefrom. We further agree that we are not entitled to rely on the accuracy or completeness of the Information and that we will be entitled to rely solely on any representations and warranties as may be made to us in any definitive agreement with respect to the Transaction, subject to such limitations and restrictions as may be contained therein.

App. at 197, ¶ 5. Dow was not a party to the Confidentiality Agreement but is alleged to have been a "controlling person" of Destec within the meaning of § 20(a) of the Exchange Act.

The Offering Memorandum included projections and estimates about the future performance of Destec's businesses, including DEI and the Elsta Plant. Like the Confidentiality Agreement, the Offering Memorandum warned readers that they were not to rely on the accuracy or completeness of information contained therein. It further stated:

> [o]nly those particular representations and warranties which may be made to a purchaser in a definitive agreement, when, as, and if executed, and subject to such limitations and restrictions as may be specified in such definitive agreement, shall have any legal effect.

App. at 7 (alteration in original).

Dow and Destec provided information about Destec to potential bidders in several other ways. First, Destec officers gave a presentation to potential bidders, which AES representatives attended. Dow and Destec also sent certain documents to potential bidders and made others available in a room at a Destec facility in Houston, Texas. Further, Dow and Destec gave potential bidders a computer model to value the Destec assets. This model included assumptions about the expenses and revenues of the Elsta Plant. Lastly, Dow and Destec allowed AES, as part of its due diligence, to visit the Elsta Plant.

AES contacted Dow about the possibility of purchasing the international assets of Destec. Dow responded that it would prefer to sell all of Destec, rather than dispose of it piecemeal. As a result, AES approached NGC Corporation ("NGC") to propose submitting a joint bid for all of Destec, and a joint bid was subsequently made.

The AES/NGC joint bid was accepted by Dow. The transaction took place in two steps. First, NGC acquired all of the stock of Destec pursuant to an Agreement and Plan of Merger (the "Merger Agreement") entered into by Dow, Destec, and NGC. Second, AES purchased all of the international assets of Destec, including all of DEI's outstanding stock, pursuant to an Asset Purchase Agreement between AES and NGC.

Section 4.6 of the Merger Agreement, to which AES was not a party, provided as follows:

> Except for the representations and warranties contained in this Article IV, neither Dow nor any other person makes any other express or implied representation or warranty on behalf of Dow.

App. at 235. Article IV of the Merger Agreement contained two pages of representations and warranties of Dow. It warranted that it was duly organized as a corporation; that it was

authorized to enter the agreement; that the execution and consummation of the agreement would not violate the terms of any court order or Dow contract; that no government approval was necessary; and that no broker was entitled to a fee in connection with the transaction. Article IV contained no representation or warranty with respect to the Elsta Plant.

Similarly, Section 3.4 of the Asset Purchase Agreement, signed by NGC and AES, states that "except for the representations and warranties contained in this Article III, neither NGC nor any other person (as defined in the Merger Agreement) makes any other express or implied representation or warranty on behalf of NGC." App. at 280-81, Section 3.4. The Merger Agreement defines "Person" to "mean an individual, partnership, joint venture, trust, corporation, limited liability company or other legal entity or Governmental Entity." App. at 216. Article III of the Asset Purchase Agreement contains limited representations and warranties by NGC very similar to those made by Dow in the Merger Agreement.

The Merger Agreement provided that "[t]his Agreement and the Confidentiality Agreement, and certain other agreements executed by the parties hereto as of the date of this Agreement, constitute the entire agreement, and supersedes (sic) all prior agreements and understandings (written and oral), among the parties with respect to the subject matter hereof." App. at 265, Section 9.9.

According to AES, shortly after purchasing DEI and Destec's other international assets, it realized that the Elsta Plant would cost far more to complete than its due diligence investigation had indicated and would open for operation much later than Dow and Destec had represented it would. Instead of providing the predicted $31 million in profit, the project ultimately occasioned a $70 million loss. AES contends that Dow knew specific facts about the Elsta Plant that contradicted the representations it had made prior to and during due diligence.

Its complaint alleges fourteen affirmative misrepresentations and eight material omissions upon which it relied. Some involved profit and cost projections, but others involved currently existing facts. Further, AES contends that, as part of the scheme to defraud, Dow concealed the true state of the Elsta Plant and frustrated its due diligence efforts by causing Destec and its employees to provide false and misleading information to AES.

The District Court's opinion refers to all of the above quoted provisions of the transaction documentation and "concludes that the 'no representation/non- reliance' clauses in the agreements between Dow and AES are enforceable." App. at 15. The reference to "agreements between Dow and AES" is not clear to us, but we assume for present purposes that AES's commitment in the Confidentiality Agreement was made for the benefit of Dow and, if enforceable, is enforceable by it. In that document, AES "acknowledge[d]" that no "express or implied representations or warranty as to the accuracy or completeness of the Information" had been made and agreed (1) that Destec and Dow would not have "any liability relating to the Information" and (2) that AES would be entitled to rely solely on the representations and warranties it would be able to secure in "any definitive agreement." App. at 197, ¶ 5. In order to avoid further repetition of this acknowledgment and agreement, we will refer to them hereafter as the "non-reliance" clause.

III. Analysis

A. The Federal Law

Section 10(b) of the Exchange Act prohibits the "use or employ, in connection with the purchase or sale of any security[,] . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). Rule 10b-5, which was promulgated to implement Section 10(b), makes it

unlawful for anyone engaged in the purchase or sale of a security to:

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which the were made, not misleading, or
>
> (c) To engage in any act, practice,or course of business which operates or would operate as a fraud or deceit upon any person[.]

17 C.F.R. § 240.10b-5. "To state a valid claim under Rule 10b-5, a plaintiff must show that the defendant 'made a misstatement or an omission of a material fact (2) with scienter (3) in connection with the purchase or the sale of a security (4) upon which the plaintiff reasonably relied and (5) that the plaintiff's reliance was the proximate cause of his or her injury.'" *Semerenko* v. *Cendant Corp.*, 223 F.3d 165, 174 (3d Cir.2000).

The "reasonable reliance" element of a Rule 10b-5 claim requires a showing of a causal nexus between the misrepresentation and the plaintiff's injury, as well as a demonstration that the plaintiff exercised the diligence that a reasonable person under all of the circumstances would have exercised to protect his own interests. *Straub* v. *Vaisman* and Co., Inc., 540 F.2d 591, 597-98 (3d Cir.1976). In *Straub*, we identified a non-exclusive set of factors to aid in determining whether a party's reliance was reasonable under all of the circumstances. We noted that courts may consider (1) whether a fiduciary relationship existed between the parties; (2) whether the plaintiff had the opportunity to detect the fraud; (3) the sophistication of the plaintiff; (4) the existence of long standing business or personal relationships; and (5) the plaintiff's access to the relevant information. *See id.* at 598.

The District Court held that as a result of AES's contractual commitment not to rely on any representations other than those incorporated in the final agreements, its alleged reliance was unreasonable as a matter of law. AES insists that this holding is incorrect in light of Section 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a). Section 29(a) provides: "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void." 15 U.S.C. § 78cc(a). That is, by its terms, Section 29(a) "prohibits waiver of the substantive obligations imposed by the Exchange Act." *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 228, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987). The underlying concern of this section is "whether the [challenged] agreement weakens [the] ability to recover under the Exchange Act." *Id.* at 230, 107 S.Ct. 2332 (quotation omitted).

B. The Applicable Law

AES emphasizes that the Merger and Asset Purchase agreements stipulated that Delaware law would govern their interpretation and insists that we must look to that law to determine the effect to be given the non-reliance clause. While we will not rule out the possibility that state law may play a role in some situations involving a Rule 10b-5 claim, we conclude that it has no role here. Reasonable reliance is an element of a federal law claim and what constitutes such reliance is a matter of federal law. Federal law calls for the determination of reasonableness to be made on a case-by-case basis based on all of the surrounding circumstances. The terms of any agreement between the parties may be among these relevant circumstances and, if there is a material dispute about what the parties agreed to, reliance on state contract law may be appropriate to resolve that dispute.

The Delaware cases relied upon by AES, however, do not involve rules of contract interpretation. Primary reliance, for example, is placed upon *Norton* v. *Poplos*, 443 A.2d 1 (Del. 1982), which involved a contract to sell commercial real estate in which the parties had represented that they "do not rely on any written or oral representations not expressly written in the contract." *Id.* at 6. The Delaware Supreme Court held that Delaware law will not enforce such a clause to bar a common law rescission claim based on fraudulent, or "innocent but material[,] misrepresentation by a seller." *Id.* AES and Dow dispute whether this is an across-the-board rule of Delaware law or whether its application is limited to non-negotiated contracts between unsophisticated parties.[2] We need not resolve that issue; the issues of what constitutes an anticipatory waiver of a federal securities claim and whether a purported anticipatory waiver of such a claim is enforceable are matters of federal law. See *Newton* v. *Rumery*, 480 U.S. 386, 107 S.Ct. 1187, 94 L.Ed.2d 405 (1987) ("the agreement purported to waive a right to sue conferred by a federal statute. The question whether the policies underlying that statute may in same circumstance render that waiver unenforceable is a question of federal law.").

C. The Role of the Non-Reliance Clause

This brings us back to Section 29(a) of the Exchange Act which forecloses anticipatory waivers of compliance with the duties imposed by Rule 10b-5. We believe the conclusion inescapable that enforcement of the non- reliance clauses to bar AES's fraud claims as a matter of law would be inconsistent with Section 29(a).

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[2] Compare, e.g., *Progressive International Corp.* v. *E.I. duPont deNemours & Co.*, 2002 WL 1558382, 2002 Del. Ch. LEXIS 91 (Del. Ch., July 9, 2002), and *Great Lakes Chem. Corp.* v. *Pharmacia Corp.*, 788 A.2d 544 (Del. Ch. 2001), with *S.C. Johnson & Son, Inc.* v. *Dowbrands, Inc.*, 167 F.Supp.2d 657, 674 (D. Del. 2001).

As we have noted, reliance is an essential element of a Rule 10b-5 claim. It necessarily follows that, if a party commits itself never to claim that it relied on representations of the other party to its contract, it purports anticipatorily to waive any future claim based on the fraudulent misrepresentations of that party. The same is true if the commitment is more limited, e.g., a promise not to claim reliance on any representation not set forth in the agreement. The scope of the anticipatory waiver is more limited, but it is nevertheless an anticipatory waiver of potential future claims under Rule 10b-5.

We, thus, find ourselves in agreement with the conclusion of the Court of Appeals for the First Circuit in *Rogen* v. *Ilikon*, 361 F.2d 260 (1st Cir.1966). There, a stockholder and former officer and director of the defendant company brought suit alleging that during negotiations for the sale of his stock after his separation from the company, officers and directors of the defendant corporation failed to disclose material information about the possibility of new prospects for the company. In the agreement to sell his stock, plaintiff represented that he was familiar with the business of the company and that he was not relying on any representations of the purchaser or its agents. In addressing the propriety of this type of contractual provision under the Exchange Act, the Court concluded:

> This [type of contract clause] is not, in its terms, a "condition, stipulation, or provision binding . . . [plaintiff] to waive compliance" with the Securities Act of 1934 as set forth in Section 29(a) of the Act, (15 U.S.C. § 78cc(a)). But, on analysis, we see no fundamental difference between saying, for example, "I waive any rights I might have because of your representations or obligations to make full disclosure" and "I am not relying on your representations or obligations to make full disclosure." Were we to hold that the existence of this provision constituted the basis (or a substantial part of the

> basis) for finding non-reliance as a matter of law, we would have gone far toward eviscerating Section 29(a).

361 F.2d at 268 (alterations in original).

As the Rogen court noted, this is not to say that a plaintiff's declaration in a contract of an intent not to rely may not be evidence that he or she did not rely on representations of the defendants. That declaration, alone or in conjunction with other evidence of non-reliance, may establish an absence of reliance and, when unrebutted, may even provide a basis for summary judgment in the defendant's favor. Thus, in this case, the non-reliance clauses are some evidence of an absence of reliance. However, the District Court did not find that the evidence of non-reliance was unrebutted. Indeed, Dow does not contend that the information provided by it and its associates played no material role in AES's decision to enter the agreement.

Dow does contend, and we understand the District Court to have held, that the non-reliance clauses establish as a matter of law that any reliance of AES was unreasonable reliance. We find the same tension between Section 29(a) and this argument, however, as we have found between Section 29(a) and the argument that the non-reliance clauses foreclose an assertion by AES that it relied. If all of the evidence bearing on the reasonableness of AES's reliance does not entitle Dow to summary judgment under traditional summary judgment principles, it would offend Section 29(a) to bar its claim based solely on a contractual commitment not to claim reliance.

IV. The Issue for Decision on Remand

This leaves for resolution the issue of whether, viewing all of the relevant circumstances and applying the reasonable reliance standard set forth in Straub, a reasonable trier of fact could only conclude that AES failed to exercise ordinary care

in protecting its own interest. We decline to address that issue, however, because we conclude that it is premature to do so.

Dow did not argue to the District Court that it was entitled to summary judgment because an application of the principles of Straub to all of the relevant circumstances of this case could lead only to one conclusion. It candidly acknowledged that the record was undeveloped with respect to AES's investigation and its failure to discover the facts it learned after settlement. It insisted, however, that the record had established the only fact necessary to require summary judgment in its favor—the existence of the non-reliance clause. Stated otherwise, Dow's argument is that it is impossible for a buyer to show reasonable reliance in any case where there is a non- reliance clause. Faced with this argument, AES understandably did not file affidavits or verify its complaint, although it did file a Rule 56(a) affidavit pointing out the need for discovery.

The non-reliance clauses are, of course, among the circumstances to be considered in determining the reasonableness of any reliance here. Importantly, they reflect the fact that the seller was unwilling to vouch for the accuracy of the information it was providing and the fact that the buyer was willing to undertake to verify the accuracy of that data for itself. Clearly, in such circumstances, a buyer who relies on seller-provided information without seeking to verify it has not acted reasonably. Clearly, a buyer in a non-reliance clause case will have to show more to justify its reliance than would a buyer in the absence of such a contractual provision. For this reason, cases involving a non-reliance clause in a negotiated contract between sophisticated parties will often be appropriate candidates for resolution at the summary judgment stage. We are unwilling, however, to hold that the extraction of a non-reliance clause, even from a sophisticated buyer, will always provide immunity from Rule 10b-5 fraud liability.

AES's complaint alleges that Dow and its subsidiaries were in exclusive control of the information necessary to accurately evaluate the Elsta Plant. It further alleges that, as a part of its fraudulent scheme to sell DEI to someone at a price far above its worth, Dow controlled release of the relevant information to AES both initially as well as during the period that it was conducting its investigation to determine the accuracy of the information initially disclosed. Much of that information involved projections and other "soft" data that a seller dealing in good faith would understandably be unwilling to guarantee. According to AES, it conducted a diligent investigation that was reasonably calculated to determine the reliability of Dow's representations but revealed no reason to suspect that Dow was intentionally misleading it. Dow allegedly saw to it that all information received by AES would reassure it of the reliability of the earlier supplied data; Dow allegedly also prevented AES from securing the data in Dow's and Destec's files that would have disclosed the fraud.

In its Rule 56(e) affidavit, AES seeks discovery of information in the exclusive possession of Dow to support AES's claim that Dow and Destec intentionally concealed their fraudulent conduct, restricted its access to truthful information, and accelerated the transaction to prevent AES from discovering the true status of the construction at the Elsta Plant.

With this as background, AES points to our observation in *Straub*:

> [A] sophisticated investor is not barred [from] reliance upon the honesty of those with whom he deals in the absence of knowledge that the trust is misplaced. Integrity is still the mainstay of commerce and makes it possible for an almost limitless number of transactions to take place without resort to the courts.

Straub, 540 F.2d at 598 (citations omitted). AES argues that a reasonable investor, in its position, trusting in the integrity of the seller, would have understood the seller's unwillingness to guarantee the truth of the supplied data as something other than a warning that it was unreliable[3] and would have been willing to rely upon an unimpeded investigation of its own.

While AES may have an uphill battle here and summary judgment for the defendants may be appropriate at some point, we decline to give controlling significance to the existence of a non-reliance clause in a vacuum. We fully appreciate that the avoidance of costly discovery is one of the objectives of negotiating such clauses. Nevertheless, to hold that a buyer is barred from relief under Rule 10b-5 solely by virtue of his contractual commitment not to rely would be fundamentally inconsistent with Section 29(a). Given this legislative directive, parties in Dow's position will have to rely upon discovery management and the summary judgment process to ameliorate the discovery burden.

In reaching this conclusion, we have not been unmindful of the decision of the Court of Appeals for the Second Circuit in

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[3] In *Semerenko*, 223 F.3d at 181, we upheld the dismissal of some of the plaintiffs' Rule 10b-5 claims against the accounting firm of Ernst & Young on the ground that the plaintiffs could not reasonably have relied upon its audit opinions after the company publicly announced the discovery of accounting irregularities and warned investors not to rely on its prior financial statements and audit reports. Dow cites *Semerenko* for the proposition that there is no need here to consider all of the circumstances in determining the reasonableness of plaintiff's reliance. The cases are not analogous, however. Dow was not saying to potential investors that it was supplying unreliable data that should not be relied upon. Rather, it was communicating only that it was not willing to absorb the risk of guaranteeing the data it was tendering to potential investors for use in evaluating DEI without having been paid for doing so as part of the contract price.

Harsco Corp. v. *Segui*, 91 F.3d 337 (2d Cir.1996). The court there affirmed the dismissal of a Rule 10b-5 security fraud claim based on a stipulation in the stock purchase agreement that the sellers were "not [to] be deemed to have made . . . any representation or warranty other than as expressly made by" the sellers in the agreement. *Id.* at 342. The *Harsco* court rejected the purchaser's argument that the District Court's dismissal had violated Section 29(a). Although acknowledging that "the underlying concern of § 29(a) is 'whether the agreement weakens the ability to recover under the Exchange Act'" and that the agreement before it could accurately be described as doing precisely that, the Court nevertheless found the "no other representation" clause enforceable:

> Thus, the Agreement can be described as weakening Harsco's ability to recover under § 10(b) of the Exchange Act. We think, however, that in the circumstances of this case such a "weakening" does not constitute a forbidden waiver of compliance. Here there is a detailed writing developed via negotiations among sophisticated business entities and their advisors. That writing, we conclude, defines the boundaries of the transaction. Harsco brings this suit principally alleging conduct that falls outside those boundaries.
>
> * * * * *
>
> Harsco bought Section 2.04's fourteen pages of representations. Unlike a contractual provision which prohibits a party from suing at all, the contract here reflects in detail the reasons why Harsco bought Multi-Serv-in essence, Harsco bought the representations and, according to Sections 2.05 and 7.02, nothing else. This means that there are fourteen pages of representations, any of which, if fraudulent, can be the basis of a fraud action against the sellers. But Harsco specifically agreed that representations not made in those

> fourteen pages were not made. Thus, it is not fair to characterize Sections 2.05 and 7.02 as having prevented Harsco from protecting its substantive rights. Harsco rigorously defined those rights in Section 2.04.
>
> This analysis becomes a question of degree and context. Harsco has not waived its rights to bring any suit resulting from this deal. Each representation in Section 2.04 is a tooth which adds to the bite of Sections 2.05 and 7.02. In different circumstances (e.g., if there were but one vague seller's representation) a "no other representations" clause might be toothless and run afoul of § 29(a). But not here.

Id. at 343, 344.

We find *Harsco*'s reasoning unpersuasive. Section 29(a) is not intended to protect substantive rights created by contract. It is designed to protect rights created by the Exchange Act, and it expressly forecloses contracting parties from "defin[ing] the boundaries of the[ir] transaction" in a way that relieves a party of the duties imposed by that Act. We do not dispute that there may be economic efficiency in allowing private parties the freedom to fashion their own bargains. But Congress has made a decision to limit that freedom when it comes to anticipatory waivers of Exchange Act claims. Accordingly, we conclude that we must side with the First Circuit Court of Appeals in *Rogen* rather than with the *Harsco* court.[4]

In addition to *Harsco*, Dow relies on *One-O-One Enters., Inc.* v. *Caruso*, 848 F.2d 1283 (D.C. Cir.1988), *Jackvony* v. *RIHT Finan. Corp.*, 873 F.2d 411 (1st Cir.1989), and *Rissman*

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[4] The *Harsco* court distinguishes *Rogen* on the grounds that it did not involve sophisticated parties or as detailed an agreement as that before it. We do not understand *Rogen* to turn on these factors. Nor do we believe § 29(a) to be susceptible of reading that would make an exception for sophisticated parties and detailed agreements.

v. *Rissman*, 213 F.3d 381 (7th Cir.2000). None of these cases address § 29(a). Moreover, as we read them, each provides some support for the approach we hold that the District Court should have taken here—treat the existence of the non-reliance clause as one of the circumstances to be taken into account in determining whether the plaintiff's reliance was reasonable. See the analysis of these decisions in *Rissman*, 213 F.3d at 387-389 (Rovner, J., concurring). As the District of Columbia Court of Appeals has observed in commenting on *One-O-One*, a contrary reading "would leave swindlers free to extinguish their victims' remedies simply by sticking in a bit of boilerplate." *Id.* at 388.

V. Conclusion

The judgment of the District Court will be reversed and this matter will be remanded for further proceedings consistent with this opinion.

WALLACE, *Senior Circuit Judge*, concurring and dissenting:

I agree the case should be reversed, but disagree on the evidentiary use of the stipulations and waivers on remand.

Section 29(a), 15 U.S.C. § 78cc(a), states, "Any . . . stipulation . . . binding any person to waive compliance with [the Securities Exchange Act] . . . shall be void." AES and Dow's stipulations are waivers of compliance, and under the express terms of section 29, they are "void." The majority holds that the void stipulation can nonetheless be evidence of the reasonableness of AES's reliance. I write separately because I cannot join in the majority's interpretation of the word "void."

A void clause is "of no effect whatsoever." BLACK'S LAW DICTIONARY 1568 (7th ed.1999). It is "an absolute nullity." *Id.* It is "ineffective," "useless," "having no legal force or validity." THE AMERICAN HERITAGE DICTIONARY 911 (4th ed. 2001). If

we permit the void stipulation to have evidentiary value, it is no longer a nullity, ineffective, or useless. Instead, it becomes a very potent weapon in the 10b-5 defendant's arsenal. This is precisely what section 29(a) prohibits.

At its core, section 29 seeks to prevent parties from contractually avoiding the requirements of Rule 10b-5. If the void stipulation may be evidence in a later Rule 10b-5 claim, how likely is it that the seller of securities will lose the 10b-5 claim? Imagine the mountains of evidence the 10b-5 plaintiff will need to compete with the evidence of the stipulation. Realistically, how will a plaintiff convince a reasonable juror that he reasonably relied on a representation when he signed a provision that stated otherwise? To permit the void stipulation to serve as evidence of a lack of reasonable reliance would be to take the teeth out of section 29. It would make a 10b-5 claim logically possible, but essentially hopeless. Congress meant more when it enacted section 29(a).

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE

AES CORPORATION, *Plaintiff*,

v.

DOW CHEMICAL COMPANY, *Defendant*.

No. CIV A 99-673-JJF.
Aug. 2, 2001.

MEMORANDUM OPINION

FARNAN, *District Judge*.

Presently before the Court is Defendant Dow Chemical Company's Motion for Summary Judgment (D.I.109). For the reasons stated below, Defendant's Motion for Summary Judgment (D.I.109) will be granted.

BACKGROUND

I. Procedural Background

Plaintiff AES Corporation ("AES") filed an Amended Complaint (D .I. 67) against Defendants Destec Energy, Inc. ("Destec Energy") and Dow Chemical Company ("Dow") asserting securities fraud claims under the Securities Exchange Act of 1934 (the "Exchange Act"), the Texas Securities Act, a claim under section 27.01 of the Texas Business and Commerce Code and common law claims for fraud and conspiracy. AES dismissed all of its claims against Destec Energy. (D.I.71). Dow moved to dismiss all claims asserted against it. Bv Memorandum Opinion and Order dated January 19, 2001, the Court granted Dow's Motion to Dismiss with respect to

Plaintiff's claims arising under the Texas Securities Act and denied Dow's Motion to Dismiss with respect to all other claims. (D.I.102, 103).

Pursuant to Federal Rule of Civil Procedure 56, Dow now moves for summary judgment against AES based on certain clauses in the transaction documents. The parties have fully briefed the motion, and the Court held oral argument on the motion on April 24, 2001.

II. Factual Background

Because Dow brings this motion before discovery has been conducted, the following facts are based upon the allegations in the Amended Complaint (D.I.67) and the four documents submitted by Dow in support of its motion for summary judgment (D.I.111).

A. The Parties

AES, a Delaware corporation with its principal place of business in Virginia, buys and operates power facilities domestically and internationally as part of its business activities. (D.I.67, ¶ 8). Dow is a Delaware corporation with its principal place of business in Michigan. *Id.* at ¶ 9. Prior to the transaction at issue, Dow was the majority shareholder of Destec Energy, which in turn was the parent of Destec Engineering, Inc. ("Destec Engineering"). *Id.* at ¶¶ 9, 16.

B. The Transaction

AES acquired the shares of Destec Engineering pursuant to a plan for NGC Corporation ("NGC") and AES to acquire Destec Energy for approximately $1.2 billion and divide the company between them, with NGC retaining Destec Energy's domestic assets and AES acquiring Destec Energy's international assets, including Destec Engineering. (D.I.67, ¶¶ 36, 47, 48). The transaction was structured in two steps. First, on February 17, 1997, Dow, Destec Energy and NGC entered

into the Agreement and Plan of Merger by and among Destec Energy, Inc., The Dow Chemical Company, NGC Corporation and NGC Acquisition Corporation II ("Merger Agreement") whereby NGC purchased all of Destec Energy from Dow. (D.I.111, Exh. B). Second, also on February 17, 1997, NGC and AES entered into the Asset Purchase Agreement by and between NGC Corporation and The AES Corporation, and as amended June 29, 1997 ("Asset Purchase Agreement") whereby AES purchased the international assets of Destec Energy, including the shares of Destec Engineering, from NGC. (D.I.111, Exh. C, C-1).

AES alleges that Dow and Destec Energy conspired to sell Destec Energy and its international assets at an artificially inflated price by misrepresenting the future prospects of Destec Engineering, a subsidiary of Destec Energy. (D.I.67, ¶ 1). Specifically, the Amended Complaint asserts that Dow and Destec Energy misrepresented the expected completion date and profit potential of an ongoing Destec Engineering project to build a power plant ("Elsta") in Terneuzen, The Netherlands. *Id.* at ¶¶ 1-2, 50-51, 62. AES alleges that Dow and Destec Energy provided AES with false information regarding the Elsta project that was central to AES's valuation of Destec Engineering, and directly resulted in AES paying at least $70 million more than it would have if AES had been provided with accurate information regarding Elsta. *Id.* at ¶¶ 40-46, 62-64. None of the representations and warranties set forth in the Asset Purchase Agreement and incorporated from the Merger Agreement concern any predicted completion date or profit potential for the Elsta project.

Dow denies that there was any fraudulent scheme and disputes AES's principal factual allegations. (D.I. 110, at 4). For purposes of this motion, however, Dow contends that these factual allegations are immaterial.

C. The Transaction Documents

The transaction at issue was initiated by Dow and Destec Energy in October of 1996, when they solicited buyers for Destec Energy. (D.I.67, ¶ 35). When AES expressed initial interest in the transaction, Destec Energy required AES to sign a Confidentiality Agreement dated October 24, 1996 before receiving Destec Energy's Offering Memorandum and other information about its business. (D.I.111, Exh. A). The Confidentiality Agreement provided that AES would not rely on any information it would receive from Destec Energy during its due diligence investigation, except for those specific representations it negotiated to be made in a definitive agreement:

> We [AES] acknowledge that neither you [Destec Energy], nor Morgan Stanley [Destec Energy's Investment Banker] or its affiliates, nor your other Representatives [including, by definition, Destec Energy's affiliates], nor any of your or their respective officers, directors, employees, agents or controlling persons within the meaning of section 20 of the Securities Exchange Act of 1934, as amended, make any express or implied representations or warranty as to the accuracy or completeness of the Information, and we agree that no such person will have any liability relating to the Information or for any errors therein or omissions therefrom. We further agree that we are not entitled to rely on the accuracy or completeness of the Information and that we will be entitled to rely solely on any representations and warranties as may be made to us in any definitive agreement with respect the Transaction, subject to such limitations and restrictions as may be contained therein.

(D.I.111, Exh. A, ¶ 5).

After executing the Confidentiality Agreement, AES received a copy of the Offering Memorandum (D.I.111, Exh. D), a Supplemental Financial Information document (D.I.111, Exh. E) and other information about Destec Energy. The Offering Memorandum stated that "[o]nly those particular representations and warranties which may be made to a purchaser in a definitive agreement, when, as, and if executed, and subject to such limitations and restrictions as may be specified in such definitive agreement, shall have any legal effect." (D.I.111, Exh. D., p. ii). It also expressly warned that any "statements, estimates and projections provided by Destec with respect to its anticipated future performance . . . reflect various assumptions and may not prove to be correct." *Id.* On the very first page, it stated that "the information, including the projections, contained herein" had not been independently verified, that Destec was not making "any express or implied representation or warranty as to the accuracy or completeness of the information contained herein or made available in connection with any further investigation of Destec," and that this "Memorandum shall not be deemed an indication of the state of affairs of Destec nor shall it constitute an indication that there has been no change in the business or affairs of Destec since the date hereof." *Id.* at p. i. The first page further provided that "[b]y accepting this Memorandum, the recipient acknowledges and agrees to the limitations set forth herein . . ." *Id.* The Offering Memorandum also noted that its delivery to a limited number of highly qualified bidders was "subject to the prior execution of a Confidentiality Agreement." *Id.*

The Merger Agreement consummating the sale of Destec Energy expressly stated that "[e]xcept for the representations and warranties contained in this Article IV, neither Dow nor any other Person makes any other express or implied representation or warranty on behalf of Dow." (D.I.111, Exh. B, § 4.6). A parallel provision limits any representations and warranties of Destec Energy to those that appear in the Merger Agreement

itself. *Id.* at § 3.20. The Merger Agreement did not contain any representations or warranties regarding the predicted completion date or potential profit for the Elsta project. The Merger Agreement further provided that "[t]his Agreement and the Confidentiality Agreement, and certain other agreements executed by the parties hereto as of the date of this Agreement, constitute the entire agreement, and supersedes all prior agreements and understandings (written and oral) among the parties with respect to the subject matter hereof." *Id.* at § 9.9.

Similarly, the Asset Purchase Agreement signed by AES expressly states that "[e]xcept for the representations and warranties contained in this Article III, neither NGC nor any other Person (as defined in the Merger Agreement) makes any other express or implied representations or warranties on behalf of NGC." (D.I.111, Exh. C, § 3.4). The representations and warranties set forth in the Asset Purchase Agreement and incorporated from the Merger Agreement comprise over twenty single-spaced pages. None of these representations or warranties, however, concern any predicted completion date or potential profit for the Elsta project. The Asset Purchase Agreement further provided that "[t]his Agreement constitutes the entire agreement, and supersedes all prior agreements and understandings (written and oral) among the parties with respect to the subject matter hereof." *Id.* at § 9.9.

STANDARD OF REVIEW

Rule 56(c) of the Federal Rules of Civil Procedure provides that summary judgment may be granted if the Court determines "that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). In making this determination," 'courts are to resolve any doubts as to the existence of genuine issues of fact against the moving parties.'" *Hollinger* v. *Wagner Mining Equipment Co.*, 667 F.2d 402, 405 (3d Cir.1981) (citations omitted). Furthermore, any reasonable inferences drawn from

the underlying facts must be viewed in the light most favorable to the non-moving party. *Spain* v. *Gallegos*, 26 F.3d 439, 446 (3d Cir.1994) (citing *Petruzzi's IGA Supermarkets, Inc.* v. *Darling-Delaware Co.*, 998 F.2d 1224, 1230 (3d Cir.1993)).

DISCUSSION

To state a violation of section 10(b) and Rule 10b-5 of the Exchange Act, Plaintiff must demonstrate that Defendant (1) made a misstatement or an omission of a material fact (2) with scienter (3) in connection with the purchase or the sale of a security (4) upon which Plaintiff reasonably relied and (5) that Plaintiff's reliance was the proximate cause of Plaintiff's injury. *Semerenko* v. *Cendant Corp.*, 223 F.3d 165, 174 (3d Cir.2000). Moreover, Plaintiff's reliance on the alleged misstatement or omission must be reasonable, even though Defendant has the burden of proof to show it was not reasonable. *Straub* v. *Vaisman & Co.*, 540 F.2d 591, 598 (3d Cir.1976). Consequently, the Court of Appeals for the Third Circuit has stated that to recover under section 10(b) and Rule 10b-5, "the plaintiff [must] act reasonably" and that "a sophisticated investor is not barred by reliance upon the honesty of those with whom he deals in the absence of knowledge that the trust is misplaced." *Id.* (emphasis added). Thus, "an investor cannot close his eyes to a known risk" and if he is "cognizant of the risk, then there is no liability." *Teamsters Local 282 Pension Trust Fund* v. *Angelos*, 762 F.2d 522, 530 (7th Cir.1985). Accordingly, a securities action defendant may obtain summary judgment by demonstrating that the plaintiff's reliance on the defendant's statements was unreasonable as a matter of law.

In support of its motion, Dow relies upon the various provisions set forth in the transaction documents. Dow asserts that AES cannot establish that it reasonably relied on the alleged misrepresentations causing its harm because: (1) it expressly agreed that it would not rely on any representations not contained in a final and definitive agreement for a

transaction, and (2) although it negotiated for numerous, specific representations and warranties in the definitive agreements, none of the alleged representations cited by AES in the Amended Complaint are contained in the parties' written agreements.

Dow relies principally upon four decisions rendered by Courts of Appeals in support of its motion. AES contends that the cases relied upon by Dow do not bar AES's securities fraud claims. According to AES, the Court should look to Delaware common law to determine whether AES can establish reasonable reliance. However, federal securities cases from this circuit and elsewhere consistently cite federal law in determining the issue of reasonable reliance. See, e.g., *Semerenko*, 223 F.3d at 178-79 (citing only federal cases on issue of reasonable reliance); *Rissman*, 213 F.3d at 383-84. The Court will consider the federal decisions cited by Dow to determine whether the contract provisions in the instant case render Plaintiff's reliance on the alleged misrepresentations unreasonable as a matter of law.

The first case Dow cites is *Rissman* v. *Rissman*, 213 F.3d 381 (7th Cir.2000). In *Rissman*, the plaintiff, a former minority shareholder of Tiger Electronics, brought a securities fraud action against the majority shareholder after the company was sold for far more than the plaintiff was paid for his stock. *Id.* at 382. The plaintiff claimed that the defendant fraudulently induced him to sell his stock by assuring him that Tiger Electronics would not be sold. *Id.* During negotiations, the defendant refused to make a representation that he would never sell the company. *Id.* at 383. Also, as part of the stock transaction, the plaintiff represented that he had not relied on any prior statements. *Id.*

In granting summary judgment in favor of the defendant, the Court of Appeals for the Seventh Circuit held that "a written anti-reliance clause precludes any claim of deceit by prior

representations." *Id.* at 384. The court reasoned that a non-reliance clause "ensures that both the transaction and any subsequent litigation proceed on the basis of the parties' writings, which are less subject to the vagaries of memory and the risks of fabrication." *Id.*

Second, Dow relies upon *Harsco Corp.* v. *Segui*, 91 F.3d 337 (2d Cir.1996). In *Harsco*, the Court of Appeals for the Second Circuit affirmed the dismissal of a Rule 10b-5 claim premised on a representation that did not appear in the parties' final agreement. *Id.* at 339. In that case, the parties' agreement contained: (1) numerous other representations and warranties, (2) a clause stating that the sellers "shall not be deemed to have made to Purchaser any representation or warranty other than as expressly made by [the sellers]" in the written agreement itself, and (3) a merger clause stating that the written agreement contains the entire agreement between the parties. *Id.* at 342-43. In holding that the buyer could not sustain a claim for securities fraud premised on a representation that did not appear in the final agreement, the court stated:

> Here there is a detailed writing developed via negotiations among sophisticated business entities and their advisors. That writing, we conclude, defines the boundaries of the transaction. *Harsco* brings this suit principally alleging conduct that falls outside those boundaries.

Id. at 343.

Also, in an opinion authored by now-Justice Breyer, the Court of Appeals for the First Circuit held that a merger clause in the parties' final agreement and the disclaimers in a proxy statement precluded plaintiff from relying on any "pre-Agreement statements" in a securities fraud claim. *Jackvony* v. *RIHT Fin. Corp.*, 873 F.2d 411, 416 (1st Cir.1989). In *Jackvony*, the court noted that plaintiff was a sophisticated investor who helped draft the written acquisition documents and

the proxy statement told plaintiff not to rely upon any such statements. *Id.* The court concluded that these factors militated against any reliance being "reasonable." *Id.*

Similarly, in an opinion authored by now-Justice Ginsburg, the D.C. Circuit held that a merger clause "superced[ing] any and all previous understandings and agreements" barred plaintiffs' securities fraud claim premised on a representation outside the parties' final agreement because such a provision "made any reliance by plaintiffs on prior representations . . . unreasonable." *One-O-One Enters., Inc.* v. *Caruso*, 848 F.2d 1283, 1286 (D.C.Cir.1988). The circuit court acknowledged the following observations made by the district court in that case:

> After eight months of vigorous negotiations, the parties reached a final agreement that was lengthy, detailed and comprehensive. During these eight months, many offers, promises and representations were made . . . To avoid a misunderstanding and to make clear that the only understanding between the parties was that expressed in the Agreement, the parties agreed that the Agreement "*supersede[d] any and all previous understandings and agreements.*"

Id. The court explained that "[w]ere we to permit plaintiffs' use of the defendants' prior representations . . . to defeat the clear words and purpose of the Final Agreement's integration clause, 'contracts would not be worth the paper on which they are written.'" *Id.* at 1287.

In the Court's view, the facts of this case place it squarely within the precedent of the four cited decisions, and therefore, the Court concludes that the "no representation/non-reliance" clauses in the agreements between Dow and AES are enforceable. The agreements at issue were negotiated by sophisticated parties negotiating at arm's length. AES, Dow and NGC are all substantial companies, and AES describes itself as

a company that "buys and operates power facilities domestically and internationally." (D.I.67, ¶ 8). When transacting business, companies such as these must be able to rely on the written words of their agreements. In sum, the Court is persuaded that the rationale of the four federal circuit court decisions is sound and should be applied here. Thus, the Court will consider whether these clauses are enforceable in light of AES's remaining arguments.

AES contends that the non-reliance and merger clauses are void because they violate Section 29(a) of the Exchange Act. Section 29(a) provides:

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

15 U.S.C. § 78cc (2000).

In support of its argument, AES cites *Rogen* v. *Ilikon Corp.*, 361 F.2d 260 (1st Cir.1966). In *Rogen*, the plaintiff, an individual shareholder of the defendant company, sued under s 10(b), alleging that he was induced to sell shares of a company back to the company at an unfair price by nondisclosure of positive information regarding the company's prospects. *Rogen*, 361 F.2d at 263. The district court granted summary judgment in part because the sales agreement at issue stated that plaintiff "[was] fully familiar with the business and prospects of the corporation, [was] not relying on any representations or obligations to make full disclosure with respect thereto, and ha[s] made such investigation thereof as [plaintiff] deem[s] necessary." *Id.* at 265. In reversing the district court, the Court of Appeals for the First Circuit held that § 29(a) rendered such a contract provision void. *Id.* at 268.

Dow contends that *Rogen* is distinguishable from the instant case and cites the Second Circuit's decision in *Harsco* to support its position. In *Harsco*, the defendants attempted to analogize the contractual provision and circumstances of *Rogen* to their case. *Harsco*, 91 F.3d at 344. In rejecting this analogy, the Second Circuit noted that the court in *Rogen* "emphasized the disparity in bargaining power between the plaintiff, an individual whom a jury could conclude was 'overtrusting,' and the defendant corporation." *Id.* at 344 (quoting *Rogen*, 361 F.2d at 267-68). In contrast, the parties in *Harsco* were "sophisticated business entities negotiating at arm's length." *Harsco*, 91 F.3d at 344. The Court of Appeals for the Second Circuit reasoned that:

> *Harsco* bought the representations [in the final agreement] and, according to Sections 2.05 and 7.02, nothing else. This means that there are fourteen pages of representations, any of which, if fraudulent, can be the basis of a fraud action against the sellers. But *Harsco* specifically agreed that representations not made in those fourteen pages were not made.

Id.

The Court finds the facts in *Harsco* to be closer to the facts of this dispute and concludes that the reasoning of *Harsco* is more persuasive than *Rogen*. Here, the Merger Agreement included more than twenty pages of specific representations and warranties. (D.I.111, Exh. B, Art. III, IV). As previously noted, this is not a case of an unsophisticated and unsuspecting buyer. Indeed, AES, Dow and NGC are all "Fortune 500" companies negotiating at arm's length. In these circumstances, the Court concludes that Section 29(a) of the Exchange Act does not bar the enforcement of a clause disclaiming representations and warranties not appearing in a final agreement negotiated between sophisticated parties in an arm's length transaction.

AES' final argument is that summary judgment at this juncture is premature. In *Straub* v. *Vaisman & Co.*, 540 F.2d 591 (3d Cir.1976), the Court of Appeals for the Third Circuit stated that a variety of factors should be considered in determining whether plaintiff's reliance was reasonable. *Straub*, 540 F.2d at 598. There are five *Straub* factors: (1) the existence of a fiduciary relationship; (2) the plaintiff's opportunity to detect the fraud; (3) the sophistication of the plaintiff; (4) the existence of a longstanding business or personal relationship; and (5) access to the relevant information. *Id.*; *Kline* v. *First Western Gov't Sec., Inc.*, 24 F.3d 480, 488 (3d Cir.1994).

Applying the *Straub* factors to this case, the Court first concludes that AES did not have a fiduciary relationship with Dow. Second, with respect to the opportunity to detect the fraud and the access to relevant information, the Amended Complaint reveals that AES received "detailed" documentation (including access to an entire "document room" at Destec) and access to Destec employees around the world. (D.I.67, ¶¶ 35, 37-38, 40-44, 62). In fact, the Confidentiality Agreement was executed for the very purpose of giving AES access to non-public information, subject to AES' written understanding that not all such information would be reliable. AES was also free to seek information from numerous third parties, such as the Elsta project's contractors, independent engineers, regulators, financiers and the two Dutch utilities owning half the plant, about the likelihood of the project finishing on schedule. Third, AES is a sophisticated business entity that was represented in the transaction by outside counsel. Fourth, AES does not assert the presence of any long-standing business or personal relationships. In sum, application of the *Straub* factors to the instant case leads the Court to conclude that Dow has established that any reliance by AES on the alleged misrepresentations was unreasonable as a matter of law.

Because the Court concludes AES' claims under the federal securities laws fail as a matter of law, the Court must consider whether to exercise supplemental jurisdiction over the Texas state law claims asserted by AES. Where all federal claims are dismissed before trial, the court should dismiss the state law claims as well, for lack of supplemental jurisdiction. See 28 U.S.C. § 1367(c)(3); *United Mine Workers of Am.* v. *Gibbs*, 383 U.S. 715, 726, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966); *Growth Horizons, Inc.* v. *Delaware County*, 983 F.2d 1277, 1284 (3d Cir.1993). Therefore, the Court will decline to exercise supplemental jurisdiction over the Texas state law claims asserted by AES.

CONCLUSION

For the reasons discussed, the Court will grant Defendant's Motion for Summary Judgment (D.I.109) as it pertains to Plaintiff's federal law claims, and the Court will decline to exercise supplemental jurisdiction over Plaintiff's claims arising under Texas state law.

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

AES CORP., *Appellant*

v.

THE DOW CHEMICAL COMPANY; DYNEGY POWER CORPORATION F/K/A/ DESTEC ENERGY INC.

No. 01-3373

On Appeal from the United States District Court
for the District of Delaware
(D.C. Civil Action No. 99-cv-00673)
District Judge: Honorable Joseph J. Farnan, Jr.

Sur Petition for Rehearing

Before BECKER, *Chief Judge*,* SLOVITER, SCIRICA, NYGAARD, MCKEE, RENDELL, AMBRO, FUENTES, SMITH, STAPLETON** and WALLACE,** *Circuit Judges*.

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* Judge Becker was Chief Judge at the time for voting on the petition for rehearing.

** Judge Stapleton and Judge Wallace were members of the original panel. Their votes are limited to panel rehearing only.

The petition for rehearing filed by petitioner in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court en banc, the petition for rehearing is denied.

By the Court,

/s/ _____

Circuit Judge

Dated: May 13, 2003

APPENDIX D

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

AES CORP., *Appellant*,

v.

THE DOW CHEMICAL COMPANY; DYNEGY POWER CORPORATION F/K/A DESTEC ENERGY INC.

No. 01-3373

On Appeal from the United States District Court
for the District of Delaware
(D.C. Civil Action No. 99-cv-00673)
District Judge: Honorable Joseph J. Farnan, Jr.

Argued May 23, 2002.

Before MCKEE, STAPLETON AND WALLACE,* *Circuit Judges*.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of Delaware and was argued by counsel on May 23, 2002.

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* Honorable J. Clifford Wallace, United States Circuit Judge for the Ninth Circuit, sitting by designation.

On consideration whereof, it is now here ORDERED AND ADJUDGED by this Court that the judgment of the said District Court entered August 6, 2001, be and the same is hereby REVERSED and this matter is REMANDED for further proceedings consistent with this opinion. Costs taxed against appellee. All of the above is in accordance with the opinion of this Court.

ATTEST:

/s/
Clerk

Dated: April 14, 2003